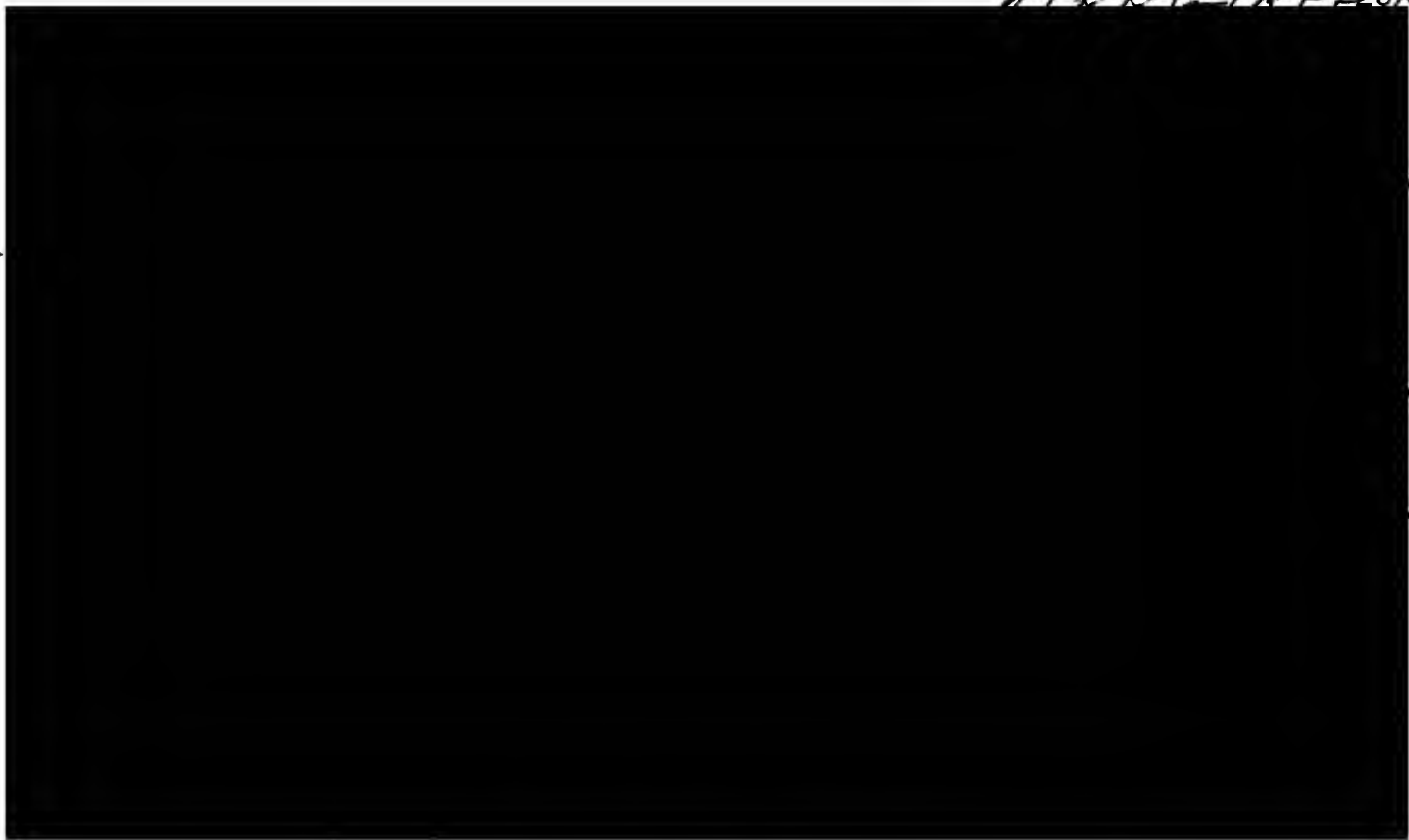


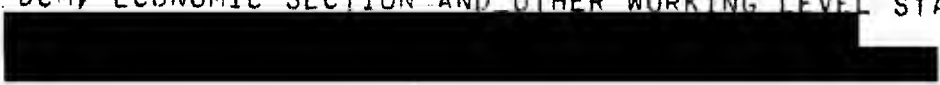
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 25X1A ENDING 2 FEBRUARY 1978. REQUEST ARTICLE BE PASSED TO AMBASSADOR,  
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OPEC COUNTRIES: CURRENT SURPLUS TO DROP IN 1978.

(THIS ARTICLE SUMMARIZES THE FINDINGS OF A  
 FORTHCOMING PUBLICATION, OPEC COUNTRIES: FINANCIAL STATUS  
 IN 1978, BY THE OFFICE OF ECONOMIC RESEARCH.)

1. THE 1978 CURRENT ACCOUNT SURPLUS&& (&BALANCE ON GOODS,  
 SERVICES, AND PRIVATE TRANSFERS,) OF OPEC COUNTRIES  
 WILL PROBABLY DECLINE TO \$36 BILLION FROM \$45 BILLION IN  
 1977, GIVEN THE RECENT FREEZING OF THEIR OIL PRICES AND  
 THE CONTINUED RISE IN THEIR IMPORT PRICES. SAUDI ARABIA  
 AND THE UNITED ARAB EMIRATES (UAE), TWO OF THE WEALTHIEST  
 OIL PRODUCERS, WILL ABSORB ALMOST THREE-QUARTERS OF THE  
 DECLINE. THE IMPACT OF THE FREEZE ON THE FINANCIAL POSITIONS  
 OF INDIVIDUAL MEMBER COUNTRIES DEPENDS ON THEIR OIL  
 PRODUCTION, ASSET HOLDINGS, PATTERNS OF FOREIGN TRADE,  
 AND DEVELOPMENT AMBITIONS. IF OIL PRICES SHOULD RISE  
 MODERATELY IN JUNE, LITTLE FINANCIAL IMPACT WILL BE FELT  
 WITHIN OPEC COUNTRIES BEFORE 1979.

2. PROJECTIONS OF OPEC OIL EARNINGS FOR 1978 WERE  
 BASED ON EXPORT ESTIMATES OF 29.9 MILLION B/D VALUED AT  
 YEAREND 1977 PRICES. THE PRICES OF OPEC IMPORTS WERE  
 ASSUMED TO BE 6 PERCENT HIGHER THAN IN 1977, A FIGURE  
 BASED ON ESTIMATES OF INFLATION IN OECD COUNTRIES, WHICH  
 ARE MAJOR SUPPLIERS FOR OPEC STATES.

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## SURPLUS COUNTRIES.

3. KUWAIT, QATAR, SAUDI ARABIA, AND THE UAE WILL RUN MASSIVE CURRENT ACCOUNT SURPLUSES IN 1978 RELATIVE TO THE SIZE OF THEIR ECONOMIES, AS THEY HAVE FOR THE PAST FOUR YEARS. THEY WILL RECEIVE 40 PERCENT OF TOTAL OPEC OIL REVENUES THIS YEAR, DESPITE PRODUCTION CUTBACKS BY SAUDI ARABIA AND THE UAE. SAUDI ARABIAN OIL PRODUCTION IS EXPECTED TO FALL BY 890,000 B/D IN 1978 TO MEET A GOVERNMENT-IMPOSED PRODUCTION CEILING OF 8.5 MILLION B/D.

4. THIS YEAR THE FOUR COUNTRIES WILL INVEST ABOUT \$20 BILLION IN WESTERN FINANCIAL MARKETS, ALREADY AWASH WITH EXCESS LIQUIDITY. ON THE ADVICE OF WESTERN INVESTMENT COUNSELORS, THEY HAVE BEEN EXPANDING THE LONG-TERM PORTION OF THEIR FOREIGN ASSET HOLDINGS TO INCREASE THE RATE OF RETURN ON THEIR PORTFOLIOS. THE BENEFITS OF A LONGER MATURITY STRUCTURE OF ASSET HOLDINGS WERE PARTIALLY OFFSET BY THE DECLINE IN LONG-TERM INTEREST RATES IN 1976; IN GERMANY, JAPAN, AND THE UNITED KINGDOM, THE DECLINE CONTINUED IN 1977.

5. THE FOUR NATIONS ARE ESPECIALLY INTERESTED IN MAXIMIZING INVESTMENT INCOME BECAUSE THEY WILL HAVE TO RELY HEAVILY ON THIS INCOME TO PAY FOR IMPORTS AS OIL RESOURCES ARE DEPLETED. THEY RECOGNIZE THE LIMITED POTENTIAL OF THEIR DOMESTIC ECONOMIES TO DEVELOP ALTERNATIVE EXPORTS TO REPLACE OIL.

6. DESPITE A 10-PERCENT DECLINE IN 1978, THE LIBYAN CURRENT ACCOUNT SURPLUS WILL REMAIN LARGE RELATIVE TO THE SIZE OF ITS ECONOMY. LIBYA SPENDS A LARGER SHARE OF ITS OIL EARNINGS ON IMPORTS THAN KUWAIT OR THE UAE, COUNTRIES THAT EXPORT A SIMILAR AMOUNT OF OIL AND ALSO HAVE SMALL POPULATIONS. ALTHOUGH LIBYA CANNOT EXPAND OIL PRODUCTION, THE MAGNITUDE OF ITS OIL EARNINGS--A PROJECTED \$11 BILLION IN 1978--WILL PERMIT IT NOT ONLY TO INCREASE IMPORT EXPENDITURES BUT ALSO TO CONTINUE LENDING FUNDS TO THIRD WORLD COUNTRIES.

7. IN 1978 IRAN AND IRAQ WILL RUN LARGE CURRENT ACCOUNT SURPLUSES FOR THEIR SIZE BUT WILL NOT BE FLOODED WITH EXCESS FUNDS LIKE KUWAIT, SAUDI ARABIA, AND THE UAE. IRAN AND IRAQ HAVE FAR MORE POTENTIAL TO DEVELOP VIGOROUS NON-OIL SECTORS AND HAVE EXTENSIVE ECONOMIC DEVELOPMENT PROGRAMS. BOTH COUNTRIES RELY ON OIL EXPORT EARNINGS TO FINANCE THEIR DEVELOPMENT EFFORTS. IRAN WILL BE ABLE TO

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RAISE IMPORT EXPENDITURES WITHOUT REDUCING ITS CURRENT ACCOUNT SURPLUS BECAUSE OIL PRODUCTION WILL INCREASE 290,000 B/D IN 1978 DUE TO A RESURGENCE IN DEMAND FOR IRANIAN CRUDE. THE IRANIAN IMPORT VOLUME GROWTH RATE WILL BE ONLY ONE-FIFTH OF THE IRAQI RATE OF 17 PERCENT BECAUSE TEHRAN IS TRYING TO COPE WITH RAMPANT DOMESTIC INFLATION AND MANPOWER AND INFRASTRUCTURE CONSTRAINTS.

BORDERLINE AND DEFICIT COUNTRIES.

8. THE SIX BORDERLINE AND DEFICIT COUNTRIES WILL HAVE CURRENT ACCOUNTS THAT RANGE FROM A \$700 MILLION SURPLUS TO A \$1.4 BILLION DEFICIT IN 1978. THE ESTIMATED CURRENT ACCOUNT SURPLUS IN INDONESIA AND DEFICITS IN NIGERIA AND VENEZUELA WILL BE RELATIVELY SMALL, COMPARED WITH THE SIZE OF THEIR DOMESTIC ECONOMIES. ALGERIA, ECUADOR, AND ESPECIALLY GABON WILL RUN LARGE CURRENT ACCOUNT DEFICITS FOR THEIR SIZE IN 1978. SINCE NONE OF THE SIX COUNTRIES CAN EXPAND OIL OUTPUT SIGNIFICANTLY, THEY RELY ON HIGHER OIL PRICES TO EASE THEIR FINANCIAL DIFFICULTIES. EVEN IF THE OPEC MEETING LAST DECEMBER HAD RAISED OIL PRICES BY 25 PERCENT, ALGERIA, ECUADOR, AND GABON WOULD STILL HAVE BEEN IN DEFICIT IN 1978.

9. ALTHOUGH ALL SIX COUNTRIES HAVE DRAWN DOWN RESERVES IN THE PAST AS NEEDED, MOST STILL HAVE ADEQUATE RESERVE HOLDINGS. TO SUPPLEMENT OIL EARNINGS, THEY WILL BORROW ON INTERNATIONAL MARKETS AND USE THE PROCEEDS TO FINANCE SPECIFIC INDUSTRIALIZATION PROGRAMS AND EASE CASH-FLOW PROBLEMS.

10. ECUADOR AND GABON DO NOT HAVE AS MANY OPTIONS OPEN TO THEM AS THEY TRY TO COPE WITH ECONOMIC DIFFICULTIES. POLITICAL CONSIDERATIONS LIMIT FOREIGN BORROWING IN ECUADOR. GABON HAS DRAWN DOWN RESERVES TO SUCH A LOW LEVEL THAT ASSET HOLDINGS ARE NOW INADEQUATE TO COVER THE DEBT-SERVICE BURDEN. (CONFIDENTIAL NOFORN) E1,2,3 IMPDET WNINTEL.>

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DCM, ECONOMIC SECTION AND OTHER WORKING LEVEL STATE OFFICERS.

WORLD GRAIN OUTLOOK FAVORABLE.(ASTERISK)

1. ALTHOUGH THE 1977/78 WORLD GRAIN SITUATION HAS  
TIGHTENED DURING THE LAST QUARTER--WE HAVE DROPPED OUR  
PRODUCTION ESTIMATE BY 25 MILLION TONS AND SLIGHTLY RAISED OUR  
ESTIMATE OF IMPORT DEMAND--SUPPLIES ARE LARGE ENOUGH TO ENSURE  
A HIGH DEGREE OF PRICE STABILITY. TOTAL GRAIN STOCKS WILL  
STILL GO UP, WITH INCREASES IN COARSE GRAINS MORE THAN OFFSETTING  
REDUCTIONS IN WHEAT. WORLD AND US EXPORTS OF WHEAT AND CORN  
WILL PROBABLY SET RECORDS IN THE MARKETING YEAR ENDING 30 JUNE  
1978 (MY 1978).

GRAIN AS USED IN THIS ARTICLE EXCLUDES RICE.

2. WORLD GRAIN PRODUCTION IN 1977/78 IS CURRENTLY  
FORECAST AT 1,070 MILLION TONS, DOWN ABOUT 45 MILLION TONS FROM  
LAST YEAR'S RECORD, BUT STILL THE SECOND HIGHEST. THE DECLINE  
IS LARGELY IN WHEAT PRODUCTION. IT REFLECTS A 20-MILLION-TON  
CUT IN THE SOVIET CROP AND THE REDUCTION IN SOUTHERN HEMISPHERE  
PROSPECTS CAUSED BY DROUGHT IN FOURTH QUARTER 1977. WE  
ESTIMATE THAT PRODUCTION AND CONSUMPTION WILL BE IN BALANCE  
DURING 1977/78. ADDITIONS TO FREE WORLD STOCKS OF  
COARSE GRAINS, ALL IN THE UNITED STATES, ARE EXPECTED. FOR  
THE USSR AND EASTERN EUROPE A STOCK DRAW DOWN IS LIKELY. EXPORTER  
STOCKS OF WHEAT ON 30 JUNE 1978 SHOULD BE 9 MILLION TONS SMALLER  
THAN A YEAR AGO, WITH THE US SHARE RISING FROM 41 TO 48 PERCENT.

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SET A NEW HIGH OF 152 MILLION TONS, A 10-MILLION-TON INCREASE OVER LAST YEAR; A JUMP IN WHEAT EXPORTS OFFSETTING A SMALL DECLINE IN COARSE GRAINS. DECREASED IMPORT DEMAND BY THE EC WILL BE MORE THAN OFFSET BY INCREASED PURCHASES BY OTHER REGIONS AROUND THE WORLD. WITH COMPETITORS' SUPPLIES LARGELY COMMITTED, THE UNITED STATES STANDS TO GAIN FROM ANY UNFORESEEN LARGE GRAIN PURCHASES FOR DELIVERY BY 1 JULY 1978.

4. OUR TENTATIVE PROJECTION OF 1978/79 PRODUCTION, UTILIZATION, AND IMPORT DEMAND FOR GRAIN, ASSUMING AVERAGE WEATHER CONDITIONS, SHOWS THE FOLLOWING: DEMAND FOR US WHEAT AND CORN WILL REMAIN STRONG THROUGHOUT MY 1979.

SOUTHERN HEMISPHERE EXPORTERS WILL OFFER LESS.

COMPETITION FOR US GRAIN EXPORTS, ESPECIALLY CORN, DURING MY 1979.

SOVIET IMPORTS ARE FORECAST AT 20 MILLION TO 25 MILLION TONS OR SIMILAR TO MY 1978, EVENLY DIVIDED BETWEEN WHEAT AND COARSE GRAINS. THIS ESTIMATE IS BASED ON PROJECTED TREND LINE PRODUCTION OF 205 MILLION TONS.

COARSE GRAIN STOCKS OF EXPORTERS WILL BE REDUCED IN MY 1979, MOSTLY IN THE UNITED STATES, BECAUSE OF LOWER PRODUCTION AND CONTINUED GROWTH IN BOTH DOMESTIC AND FOREIGN DEMAND. ENDING WHEAT STOCKS WILL ALSO DROP IF WORLD TRADE EXCEEDS 70 MILLION TONS.

WHEAT: RECORD CONSUMPTION AND TRADE IN 1977/78.

5. WE HAVE REDUCED OUR OCTOBER WORLD WHEAT PRODUCTION ESTIMATE FOR 1977/78 BY 16 MILLION TONS, TO 384 MILLION TONS. THIS ESTIMATE IS WITHIN 1 MILLION TONS OF THOSE RECENTLY RELEASED BY THE USDA, FAO, AND THE INTERNATIONAL WHEAT COUNCIL (IWC). THE REDUCTION REFLECTS THE LARGE DROP (10 MILLION TONS) IN THE SOVIET CROP AND ADDITIONAL DROUGHT-INDUCED CUS IN THE ARGENTINE, AUSTRALIAN, AND BRAZILIAN HARVESTS, WHICH WERE NOT OFFSET BY UPWARD ADJUSTMENTS IN CANADIAN AND INDIAN CROP ESTIMATES. FOR THE FIRST TIME IN MANY YEARS, WHEAT PRODUCTION IS DOWN IN EVERY MAJOR EXPORTING COUNTRY.

6. WHEAT CONSUMPTION IN 1977/78 IS ESTIMATED AT A NEW HIGH OF 390 MILLION TONS, A 4-PERCENT INCREASE OVER LAST YEAR. WE FORECAST CONSUMPTION TO EXCEED PRODUCTION FOR THE FIRST TIME

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SINCE 1974/75. WHEAT FED TO LIVESTOCK WILL RISE SHARPLY BECAUSE OF LOW WHEAT PRICES AND PLENTIFUL SUPPLIES OF FEED-QUALITY WHEAT IN CANADA, WESTERN EUROPE, AND THE USSR. EXCEPT FOR MINOR INCREASES IN THE MIDDLE EAST, WHEAT CONSUMPTION IN MOST LOCS WILL SHOW LITTLE CHANGE AS A RESULT OF GOOD RICE CROPS AND SLOW GROWTH IN PERSONAL INCOMES.

7. WE ARE NOW FORECASTING WORLD TRADE IN WHEAT AND WHEAT FLOUR IN MY 1978 AT 72.4 MILLION TONS, UP 2.4 MILLION TONS FROM OUR OCTOBER REPORT AND 20 PERCENT LARGER THAN LAST YEAR. THIS UPWARD ADJUSTMENT REFLECTS A MILLION-TON BOOST IN BRAZIL'S IMPORT NEEDS, WITH THE BALANCE SCATTERED AMONG A NUMBER OF OTHER COUNTRIES. USDA AND THE IWC ALSO HAVE RAISED THEIR ESTIMATES SINCE LAST OCTOBER BY 3 MILLION TONS, TO 70 MILLION TONS. WHEAT IMPORTS WILL BE UP FOR EVERY REGION AROUND THE WORLD. WE ARE HOLDING TO A 6-MILLION-TON BOOST IN CHINESE IMPORTS OVER MY 1977, TO 9.2 MILLION TONS, ALL NON-UNITED STATES. ANY ADDITIONAL WHEAT PURCHASED BY CHINA IN MY 1978 WILL PROBABLY BE CANADIAN AND AUSTRALIAN WHEAT FOR DELIVERY AFTER 1 JULY 1978. DIRECT SOVIET WHEAT IMPORTS ARE ESTIMATED AT 8 MILLION TONS, UP 4.2 MILLION TONS FROM MY 1977; ANOTHER ESTIMATED 2 MILLION TONS OF WHEAT AND FLOUR PURCHASED FROM CANADA, AUSTRALIA, AND INDIA WILL BE DELIVERED TO THIRD COUNTRIES ON SOVIET ACCOUNT.

8. WORLD EXPORTABLE SUPPLIES FROM THE 1977/78 HARVEST PLUS CARRYOVER STOCKS ARE MORE THAN ADEQUATE TO MEET A GLOBAL IMPORT DEMAND OF 72 MILLION TO 73 MILLION TONS. WHEAT STOCKS ON 1 JULY 1977 FOR THE FIVE MAJOR EXPORTERS WERE AT A SEVEN-YEAR HIGH OF 64 MILLION TONS, UP 20 MILLION TONS OVER A YEAR EARLIER. PART OF THE EXPORT DEMAND WILL BE MET BY A STOCK DRAWDOWN OF ABOUT 9 MILLION TONS. EACH OF THE MAJOR EXPORTERS WILL DRAW DOWN STOCKS, EXCEPT POSSIBLY THE UNITED STATES. PROJECTED US STOCKS ON 1 JULY 1978 WILL REPRESENT 48 PERCENT OF TOTAL EXPORTER STOCKS, THE LARGEST SHARE SINCE THE 1960S. TWO YEARS EARLIER IT WAS ONLY 34 PERCENT.

9. US WHEAT EXPORTS IN MY 1978 COULD SET A NEW HIGH. WE ARE NOW FORECASTING EXPORT DEMAND AT 32.4 MILLION TONS (1.2 BILLION BUSHEL), 26 PERCENT LARGER THAN A YEAR AGO AND 3 MILLION TONS MORE THAN OUR OCTOBER ESTIMATE. PRIVATE TRADERS ALSO ARE ESTIMATING A 1.2-BILLION-BUSHEL EXPORT LEVEL; THE USDA EXPECTS 1.1 BILLION BUSHEL, OR 29.9 MILLION TONS. TO REACH OUR ESTIMATED EXPORT VOLUME, SHIPMENTS MUST ACCELERATE IN SECOND HALF MY 1978.

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10. A LARGE SHARE OF THE INCREASE IN US EXPORT DEMAND RESULTS FROM THE SHORTFALL IN ARGENTINE AND AUSTRALIAN SUPPLIES. IN ADDITION, DEMAND FOR US WHEAT HAS BEEN HELPED BY (A) A CANADIAN SHORTAGE OF DURUM AND HIGH MILLING QUALITY WHEATS, (B) A BOOST IN CCC AND PL-480 PROGRAMS, AND (C) THE LESSENERED VALUE OF THE DOLLAR. COMPARED WITH MY 1977, US EXPORTS WILL BE UP FOR EVERY MAJOR REGION EXCEPT ASIA. ESTIMATED DELIVERIES TO THE SOVIET UNION AND WESTERN EUROPE WILL RISE BY 1.5 MILLION TONS EACH AND TO LATIN AMERICA BY 2.4 MILLION TONS. THE UNITED STATES REMAINS THE ONLY MAJOR EXPORTER WITH SUFFICIENT WHEAT AND LOGISTIC CAPABILITY TO EXPAND SHIPMENTS BEYOND OUR CURRENT FORECAST FOR DELIVERY BY 1 JULY 1978.

COARSE GRAINS: (ASTERISK) LOWER WORLD PRODUCTION AND HIGHER IMPORT DEMAND IN 1977/78.

11. WE ESTIMATE THAT WORLD PRODUCTION OF COARSE GRAINS IN 1977/78 WILL BE ABOUT 683 MILLION TONS, SLIGHTLY LESS THAN THE USDA FORECAST AND 9 MILLION TONS BELOW LAST YEAR. ONLY THE UNITED STATES AND WESTERN EUROPE ARE LIKELY TO REGISTER APPRECIABLE INCREASES OVER 1976/77. THE PRODUCTION OF CORN--THE MOST IMPORTANT COARSE GRAIN--IN 1977/78 IS PROJECTED AT 341 MILLION TONS, 4 MILLION TONS ABOVE 1976/77. THE MAIN SOUTHERN HEMISPHERE CORN EXPORTERS--ARGENTINA, BRAZIL, AND SOUTH AFRICA--WILL HAVE SMALLER CORN HARVESTS THIS COMING SPRING BECAUSE OF LESS FAVORABLE WEATHER. THAILAND'S CORN HARVEST LAST SUMMER WAS ALSO CUT BY DROUGHT. WESTERN EUROPE'S TOTAL COARSE GRAIN PRODUCTION IS UP 32 PERCENT OVER THE 1976/77 DROUGHT-STRICKEN HARVEST, INCLUDING A 38-PERCENT INCREASE IN CORN PRODUCTION IN THE EC. THE INCREASE IN EASTERN EUROPE'S TOTAL GRAIN PRODUCTION IS SOLELY A RESULT OF HIGHER OUTPUT OF COARSE GRAINS, WHILE IN THE SOVIET UNION PRODUCTION IS DOWN BY AN ESTIMATED 10 MILLION TONS.

12. (ASTERISK) INCLUDING CORN, SORGHUM, BARLEY, OATS, MILLET, RYE, AND MISCELLANEOUS GRAINS.

13. WE AGREE WITH THE USDA THAT WORLD CONSUMPTION OF COARSE GRAINS IN 1977/78 COULD REACH A RECORD 677 MILLION TONS (12 MILLION TONS ABOVE LAST YEAR) BECAUSE OF HIGHER LIVESTOCK FEED REQUIREMENTS IN DEVELOPED COUNTRIES. EUROPEAN FEEDING OF COARSE GRAIN IS EXPECTED TO INCREASE.

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BY ABOUT 2 PERCENT IN 1977/78. WHILE SOVIET USE OF COARSE GRAINS IS LIKELY TO BE DOWN IN 1977/78, THE DECLINE WILL BE MORE THAN OFFSET BY INCREASED FEEDING OF WHEAT. ASIAN FEED USE IS UP, LED BY A 6-PERCENT INCREASE IN JAPAN AND SOUTH KOREA. THE USDA PROJECTS US FEED USE OF COARSE GRAINS IN 1977/78 AT 119 MILLION TONS, 7.5 MILLION TONS ABOVE A YEAR AGO.

14. WE FORECAST WORLD IMPORT DEMAND FOR COARSE GRAINS IN MY 1978 AT 79.6 MILLION TONS, 2.7 MILLION TONS BELOW LAST YEAR AND VERY CLOSE TO THE USDA FORECAST OF 80.6 MILLION TONS. FOR CORN, WE ESTIMATE WORLD IMPORT DEMAND IN MY 1978 AT 55.4 MILLION TONS, OR 1.0 MILLION TONS LARGER THAN IN MY 1977.

15. WESTERN EUROPE'S CORN IMPORTS WILL BE DOWN SHARPLY IN MY 1978 BECAUSE OF IMPROVED DOMESTIC PRODUCTION IN EC COUNTRIES. EC IMPORTS OF CORN ARE EXPECTED TO DECLINE BY NEARLY 27 PERCENT FROM MY 1977. EASTERN EUROPE'S CORN IMPORTS WILL CONTINUE TO GROW, LARGELY A RESULT OF THE 1.5-MILLION TO 2.0-MILLION-TON INCREASE IN POLISH NEEDS. THE USSR IS EXPECTED TO TAKE 9.5 MILLION TONS OF CORN IN MY 1978, 4.6 MILLION TONS MORE THAN LAST YEAR. MEXICO'S INCREASED NEEDS ARE RESPONSIBLE FOR THE EXPECTED RISE IN WESTERN HEMISPHERE IMPORTS. JAPAN, SOUTH KOREA, AND TAIWAN WILL LEAD THE GROWTH IN ASIAN DEMAND.

16. WORLD EXPORTABLE SUPPLIES OF COARSE GRAINS, ESPECIALLY CORN, ARE MORE THAN SUFFICIENT TO COVER IMPORT DEMAND IN MY 1978 BECAUSE OF LARGE SUPPLIES IN NORTH AMERICA. THE THREE MAIN SOUTHERN HEMISPHERE CORN EXPORTERS WILL INCREASE SHIPMENTS IN MY 1978. WHILE LOWER PRODUCTION IN EACH OF THESE COUNTRIES THIS SPRING WILL CUT CORN SHIPMENTS DURING THE LAST QUARTER OF MY 1978, IT WILL HAVE THE GREATEST IMPACT ON EXPORTS DURING MY 1979. ARGENTINA'S EXPORTS OF CORN IN MY 1978 WILL INCREASE SLIGHTLY; BRAZILIAN SHIPMENTS WILL BE UNCHANGED. SOUTH AFRICA'S CORN EXPORTS DURING MY 1978 ARE EXPECTED TO BE UP BY 87 PERCENT, OR 1.3 MILLION TONS. THAILAND'S CORN EXPORTS, ESTIMATED AT ONLY 900,000 TONS, ARE BEING SEVERELY CURTAILED BECAUSE OF A POOR CROP. WHILE THE EC WILL CONTINUE TO CONSUME MOST OF ITS OWN CORN, EXTERNAL SHIPMENTS WILL GO UP SLIGHTLY. IN EASTERN EUROPE, HUNGARY AND ROMANIA ARE EXPECTED TO BOOST CORN EXPORTS.

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MILLION TONS IN MY 1978, DOWN 300,000 TONS FROM MY 1977. AUSTRALIAN SORGHUM EXPORTS WILL BE NEGLIGIBLE, AND BARLEY SHIPMENTS, 1.6 MILLION TONS, WILL BE DOWN 500,000 TONS. ALTHOUGH CANADIAN BARLEY SUPPLIES ARE UP, EXPORT SALES HAVE BEEN SLOW, AND STOCKS DURING MY 1978 COULD INCREASE BY MORE THAN ONE-THIRD.

18. WE ESTIMATE THAT FREE WORLD COARSE GRAIN STOCKS DURING 1977/78 WILL REACH A RECORD 87.2 MILLION TONS, UP 16.6 MILLION TONS FROM THE PREVIOUS YEAR. THE ADDITION TO US STOCKS, MOSTLY CORN, ACCOUNTS FOR 90 PERCENT OF THIS INCREASE.

19. FOREIGN DEMAND FOR US CORN IN MY 1978 COULD REACH A RECORD 43.2 MILLION TONS, 900,000 TONS ABOVE MY 1977. TO ACHIEVE THIS EXPORT LEVEL, US SHIPMENTS OF CORN WILL HAVE TO INCREASE 29 PERCENT IN THE SECOND HALF OF MY 1978. THIS CAN BE DONE. SCHEDULES CALL FOR LARGER SHIPMENTS TO THE USSR DURING THE BALANCE OF MY 1978, AND LESS COMPETITION FROM SOUTHERN HEMISPHERE EXPORTERS DURING THE PERIOD APRIL-JUNE SHOULD BOOST SHIPMENTS SUBSTANTIALLY.

20. OUR ESTIMATE OF US CORN EXPORTS FOR THE OFFICIAL US CROP YEAR ENDING 30 SEPTEMBER 1978 IS IN LINE WITH THE USDA MIDPOINT FORECAST OF 44.5 MILLION TONS. US CORN STOCKS ON 30 SEPTEMBER 1978 THUS WILL TOTAL 30 MILLION TONS, 7.7 MILLION TONS LARGER THAN A YEAR EARLIER AND ALMOST THREE TIMES THE STOCKS OF TWO YEARS EARLIER.

OUTLOOK GOOD FOR US WHEAT AND CORN EXPORTS IN MY 1979.

21. PROSPECTS LOOK GOOD FOR THE UNITED STATES TO MAINTAIN A HIGH LEVEL OF WHEAT-EXPORTS IN MY 1979, IN THE RANGE OF 30 MILLION TO 32 MILLION TONS, ALTHOUGH WE ESTIMATE WORLD IMPORT DEMAND TO BE DOWN 3 MILLION TO 4 MILLION TONS. THE DEMAND FOR US WHEAT WILL REMAIN STRONG BECAUSE OF REDUCED EXPORT AVAILABILITIES FROM OTHER SUPPLIERS. COMPARED WITH MY 1978, INDIA AND TURKEY ARE EXPECTED TO HAVE 2 MILLION TONS LESS FOR EXPORT; ARGENTINA ABOUT THE SAME; AUSTRALIA 0.5 MILLION TONS LESS; AND CANADA 1 MILLION TO 2 MILLION TONS LESS OF GOOD MILLING QUALITY WHEAT. ALSO, BECAUSE OF THE SMALLER 1977/78 HARVESTS AND A STOCK DRAWDOWN TO COVER MY 1978 EXPORTS, ARGENTINA AND AUSTRALIA WILL BE LARGELY OUT OF THE EXPORT MARKET UNTIL EARLY IN 1979.

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22. THE ESTIMATED CUTBACK IN WORLD IMPORT DEMAND IS BASED ON SLIGHTLY HIGHER PRICES, LOWER PRODUCTION OF FEED-QUALITY WHEAT, AND AVERAGE GROWING CONDITIONS FOR ALL FOODGRAINS. SOVIET WHEAT IMPORTS ARE EXPECTED TO REMAIN AT ABOUT 8 MILLION TONS IN MY 1979, BASED ON A TREND VALUE CALCULATION OF A 205-MILLION-TON (PLUS OR MINUS 10 MILLION) GRAIN HARVEST, INCLUDING ABOUT 95 MILLION TONS OF WHEAT. CHINA'S IMPORTS MAY BE DOWN AS MUCH AS 3 MILLION TONS UNLESS PRICES WEAKEN OR 1978 DOMESTIC GRAIN PRODUCTION FAILS TO INCREASE. INDIA, A NET EXPORTER THIS YEAR, COULD BECOME A NET IMPORTER OF 2 MILLION TO 3 MILLION TONS IN MY 1979. THE ODDS DO NOT FAVOR INDIA HAVING FOUR SUCCESSIVE GOOD HARVESTS, AND STOCKS ARE UNLIKELY TO COVER A LARGE PRODUCTION SHORTFALL.

23. THE UNITED STATES COULD EXPORT 30 MILLION TO 32 MILLION TONS OF WHEAT WITH ONLY A 1-MILLION-TON REDUCTION IN ENDING STOCK LEVELS ON 30 JUNE 1979, PROVIDED THAT 1978 PRODUCTION IS DOWN NO MORE THAN 10 PERCENT. CANADIAN STOCKS WOULD DROP BY MORE THAN A MILLION TONS IF EXPORTS REMAIN AT THE 16-MILLION-TON LEVEL. THUS, THE TOTAL STOCKS OF WHEAT HELD BY THE FIVE MAJOR EXPORTERS WOULD BE REDUCED BY ONLY ABOUT 2 MILLION TONS FROM THE 55 MILLION TONS NOW FORECAST FOR 30 JUNE 1978.

24. A NUMBER OF UNCERTAINTIES, OTHER THAN CHANGES IN PRODUCTION, SURROUND ANY PROJECTION OF MY 1979 WORLD IMPORT DEMAND FOR WHEAT. THESE INCLUDE (A) IMPORTER DECISIONS TO BUILD STOCKS, (B) FOREIGN EXCHANGE SHORTAGES, (C) SIZE OF FOOD AID PROGRAMS, AND (D) OUTPUT OF RICE.

25. PROSPECTS FOR THE NORTHERN HEMISPHERE WINTER WHEAT CROP--PLANTED LAST FALL FOR HARVEST THIS SUMMER--ARE GENERALLY BETTER THAN A YEAR AGO. SOWN ACREAGE IS UP THROUGHOUT THE HEMISPHERE WITH THE EXCEPTION OF THE UNITED STATES. LITTLE IS KNOWN YET ABOUT PLANTING INTENTIONS FOR THE SPRING WHEAT CROP OUTSIDE OF THE UNITED STATES; WE ARE CURRENTLY PROJECTING LITTLE CHANGE IN AREA FOR CANADA OR THE SOVIET UNION FROM LAST YEAR. EXCESSIVE WINTERKILL OF FALL SOWN WHEAT IN THE USSR WOULD BOOST SOVIET ACREAGE OF SPRING GRAINS. SOME EXPANSION IN ACREAGE IS PROJECTED FOR BRAZIL AND ARGENTINA BASED ON THE ASSUMPTION OF MORE FAVORABLE PLANTING CONDITIONS THIS SPRING. AUSTRALIAN WHEAT BOARD POLICY ALSO CALLS FOR A SMALL INCREASE IN SOWN ACREAGE.

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26. FOR COARSE GRAINS, WE ARE PROJECTING 1978/79 PRODUCTION AT 655-MILLION TO 685 MILLION TONS. THE MIDPOINT--670 MILLION TONS--IS 2 PERCENT OR 13 MILLION TONS, BELOW 1977/78 OUTPUT. UNLIKE 1977/78, CONSUMPTION WILL EXCEED PRODUCTION IF EXPANSION OF LIVESTOCK PRODUCTION STAYS ON TREND. LOW PRICES FOR GRAIN AND PROTEIN SUPPLEMENTS DURING MY 1978 HAVE BEEN ENCOURAGING LARGER LIVESTOCK HERDS AND A HIGHER RATE OF FEEDING. OUR ESTIMATE ASSUMES THE USSR MAINTAINS ITS POLICY OF ENCOURAGING LIVESTOCK PRODUCTION.

27. PRODUCTION IN SOUTHERN HEMISPHERE COUNTRIES--AUSTRALIA, ARGENTINA, BRAZIL, AND SOUTH AFRICA--AND THAILAND SHOULD REBOUND FROM THE DROUGHT-REDUCED LEVELS OF 1977/78. SOVIET PRODUCTION COULD ALSO INCREASE ROUGHLY BY 5 MILLION TONS BASED ON THE MIDPOINT OF A PROJECTED TREND VALUE RANGE OF 95 MILLION TO 105 MILLION TONS. INCREASES, HOWEVER, WILL BE INADEQUATE TO COMPENSATE FOR A 9-MILLION-TON REDUCTION PROJECTED FOR US OUTPUT. US COARSE GRAIN PRODUCTION OF 180-MILLION TO 205 MILLION TONS ASSUMES A SMALLER HARVESTED ACREAGE AND YIELDS LOWER THAN THE RECORD YIELDS OF 1977/78.

28. WE PROJECT WORLD IMPORT DEMAND FOR CORN AT 55 MILLION TONS IN MY 1979, ONLY ONE-HALF MILLION TONS LESS THAN IN MY 1978. THE EXPECTED REDUCTION IN THE CROPS OF SOUTHERN HEMISPHERE EXPORTERS THIS SPRING WILL INCREASE DEMAND FOR US CORN IN MY 1979 TO A NEW HIGH OF 44.8 MILLION TONS, 1.6 MILLION TONS ABOVE OUR ESTIMATE FOR THE CURRENT MARKETING YEAR.

29. EUROPEAN IMPORT DEMAND FOR CORN IN MY 1979 IS EXPECTED TO REMAIN UNCHANGED, WITH INCREASED EC IMPORTS OFFSET BY DECREASES ELSEWHERE IN WESTERN AND EASTERN EUROPE. WESTERN HEMISPHERE CORN IMPORTS ARE EXPECTED TO DROP SLIGHTLY BECAUSE OF HIGHER DOMESTIC OUTPUT. SOVIET CORN IMPORTS ARE NOT EXPECTED TO DROP BELOW 10 MILLION TONS EVEN IF TOTAL GRAIN PRODUCTION FALLS BETWEEN 195 MILLION TO 215 MILLION TONS. ASIAN IMPORTS ARE FORECAST TO CONTINUE TO GROW IN MY 1979.

30. STOCKS OF COARSE GRAINS WILL BE REDUCED DURING 1978/79 BECAUSE OF THE IMBALANCE BETWEEN PRODUCTION AND CONSUMPTION. THE BRUNT OF ANY REDUCTION WOULD BE BORNE BY THE UNITED STATES IF PROJECTIONS OF LOWER PRODUCTION AND CONTINUED GROWTH IN DOMESTIC AND FOREIGN DEMAND HOLD UP. SOVIET STOCKS ALSO COULD FALL UNLESS IMPORTS WERE TO

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25X1A EXCEED 25 MILLION TONS OR LIVESTOCK FEEDING WERE TO BE  
SHARPLY CUT. (CONFIDENTIAL NOFORN) E1,2,3 IMPDET WNINTEL.>  
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FRANCE: BRIGHTER TRADE AND CURRENT ACCOUNT PICTURE.

1. GO-SLOW ECONOMIC POLICIES ENABLED FRANCE TO CHOP  
ITS CURRENT ACCOUNT DEFICIT FROM \$6 BILLION IN 1976 TO \$2.9  
BILLION IN 1977. THREE-FIFTHS OF THE IMPROVEMENT WAS  
ACHIEVED IN TRADE, ALTHOUGH THE TRADE ACCOUNT STILL  
REGISTERED A DEFICIT OF \$2.4 BILLION. IF THE PRESENT  
GOVERNMENT REMAINS IN POWER AFTER THE MARCH PARLIAMENTARY  
ELECTIONS, SOME FURTHER IMPROVEMENT IN TRADE AND CURRENT  
ACCOUNTS IS LIKELY IN 1978. THE COMING TO POWER OF A  
LEFTIST GOVERNMENT WOULD ALMOST SURELY MOVE THE ACCOUNTS  
IN THE OTHER DIRECTION THROUGH INCREASED PUBLIC SPENDING  
AND HIGHER MONEY WAGES, WHICH WOULD SPUR IMPORTS, DAMPEN  
EXPORTS, AND ACCELERATE INFLATION IN GENERAL.

BACKGROUND.

2. FRENCH TRADE AND CURRENT ACCOUNT BALANCES HAVE  
FLUCTUATED SHARPLY SINCE THE QUADRUPLING OF OIL PRICES IN  
1973/74. A MAJOR FACTOR HAS BEEN SHIFTS BY THE GOVERNMENT  
BETWEEN POLICIES AIMED AT (A) ENCOURAGING PRODUCTION AND  
EMPLOYMENT AND (B) CURBING INFLATION AND PAYMENTS DEFICITS.  
THE OIL PRICE HIKE BOOSTED NET OIL IMPORTS FROM \$2.8  
BILLION IN 1973 TO \$8.8 BILLION IN 1974, MOVING THE TRADE  
BALANCE FROM A SURPLUS OF \$780 MILLION TO A DEFICIT OF  
\$3.9 BILLION. THE CURRENT ACCOUNT PLUNGED FROM \$690 MILLION  
TO A RECORD LOSS OF \$1.1 BILLION IN 1974.

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3. PARIS APPLIED THE ECONOMIC BRAKES IN 1975, SWINGING THE TRADE BALANCE BACK INTO SURPLUS AND RETURNING THE CURRENT ACCOUNT TO EQUILIBRIUM. THE COST WAS HIGH: REAL GDP STAGNATED, AND UNEMPLOYMENT SOARED. IN 1976, MORE EXPANSIONARY POLICIES HELPED REAL GDP TO RISE BY 5 PERCENT AND STABILIZED UNEMPLOYMENT. BUT THE CURRENT ACCOUNT RECORDED A THUMPING \$6 BILLION DEFICIT AND THE TRADE ACCOUNT, A \$4.3 BILLION DEFICIT.

#### RECENT DEVELOPMENTS.

4. THE FRENCH GOVERNMENT RETURNED TO RESTRICTIVE MONETARY AND FISCAL POLICIES IN SEPTEMBER 1976. PRIME MINISTER BARRE HAS COMMITTED HIMSELF TO REDUCING THE TRADE DEFICIT BY FOSTERING SLOW, STEADY GROWTH OF PRODUCTION. BARRE BELIEVES THAT EXCHANGE RATE MOVEMENTS CORRECT IMBALANCES IN INTERNATIONAL TRADE AND PAYMENTS TOO SLOWLY. IN HIS OPINION, A FRANC DEPRECIATION ACCOMPANYING A PERSISTENT CURRENT ACCOUNT DEFICIT WOULD ENGENDER DOMESTIC INFLATION AND FURTHER DEPRECIATION OF THE FRANC BEFORE TRADE WAS BROUGHT TO EQUILIBRIUM. UNDER THE INFLUENCE OF THE BARRE STABILIZATION MEASURES, THE CURRENT ACCOUNT DEFICIT FELL BY MORE THAN ONE-HALF, TO \$2.9 BILLION IN 1977. LARGE GAINS WERE ACHIEVED IN BOTH THE TRADE ACCOUNT AND IN THE SERVICES ACCOUNT. REAL GDP GROWTH SLOWED TO 3 PERCENT, AND UNEMPLOYMENT AGAIN MOVED UP.

5. THE TRADE DEFICIT FELL TO \$2.4 BILLION IN 1977. IN CURRENT DOLLARS, EXPORTS ROSE 18 PERCENT WHILE IMPORTS WERE UP 13 PERCENT. IN CONSTANT PRICES, EXPORTS INCREASED BY 6 PERCENT AND IMPORTS BY 2 PERCENT. THE SMALL RISE IN IMPORT VOLUME COMPARED FAVORABLY WITH A 20-PERCENT JUMP IN THE PREVIOUS YEAR.

6. TRADE GAINS WERE EVIDENT IN SEVERAL BROAD PRODUCT CATEGORIES IN 1977:

NET OIL IMPORTS FELL TO \$9.7 BILLION FROM \$10.1 BILLION THE PRECEDING YEAR. (OIL IMPORTS DROPPED FROM 19 PERCENT OF TOTAL IMPORTS IN 1976 TO 16 PERCENT IN 1977, OR FROM 2.4 MILLION TO 2.3 MILLION B/D.) CONSERVATION EFFORTS AND SLOW GROWTH OF ECONOMIC ACTIVITY WERE FACTORS IN THE DECLINE.

THE TRADE DEFICIT IN OTHER RAW MATERIALS FELL FROM \$3.2 BILLION IN 1976 TO \$2.2 BILLION IN 1977. A

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SLOWDOWN IN STOCK BUILDING AFTER THE SURGE IN LATE 1976 AIDED THE RAW MATERIALS BALANCE,

NET AGRICULTURAL EXPORTS (ABOUT 15 PERCENT OF TOTAL EXPORTS) INCREASED BY \$240 MILLION IN SECOND HALF 1977 AND MOVED INTO SURPLUS AFTER A DEFICIT-PLAGUED FIRST HALF. THE IMPROVEMENT IN AGRICULTURAL TRADE WAS HELPED BY RECOVERY IN FARM PRODUCTION FOLLOWING THE 1976 DROUGHT.

EXPORTS OF CAPITAL GOODS (ABOUT 25 PERCENT OF ALL EXPORTS) ROSE FROM \$14 BILLION IN 1976 TO \$17 BILLION IN 1977, RAISING THE SURPLUS IN CAPITAL GOODS TRADE \$500 MILLION, TO \$4 BILLION.

7. IMPROVEMENT IN THE BALANCE OF TRADE WAS WIDELY DISTRIBUTED ON A GEOGRAPHICAL BASIS AS WELL. EXPORTS TO OTHER EC COUNTRIES ROSE FROM \$28 BILLION IN 1976 TO \$33 BILLION IN 1977. THE DEFICIT IN TRADE WITH EC PARTNERS, WHICH CONSTITUTES ABOUT HALF OF TOTAL FRENCH TRADE, FELL FROM \$2.1 BILLION IN 1976 TO \$1.2 BILLION IN 1977. RECOVERY IN AGRICULTURAL PRODUCTION MADE A STRONG CONTRIBUTION. FRENCH EXPORTS TO THE UNITED STATES AND OTHER DEVELOPED COUNTRIES OUTSIDE THE COMMUNITY ROSE FROM \$11 BILLION IN 1976 TO \$13 BILLION IN 1977. THE TRADE DEFICIT WITH THESE COUNTRIES FELL FROM \$815 MILLION TO \$450 MILLION. THE CONTINUATION OF RELATIVELY STRONG RECOVERY IN THE US ECONOMY PLAYED A MAJOR PART. FRENCH EXPORTS TO ALL REMAINING COUNTRIES ROSE FROM \$18 BILLION IN 1976 TO \$21 BILLION IN 1977. THE DEFICIT IN TRADE WITH THIS GROUP, COMPRISING MAINLY LDCs AND OPEC MEMBERS, FELL FROM \$1.4 BILLION TO \$759 MILLION.

8. THE DEFICIT ON SERVICES AND TRANSFERS FELL FROM \$1.7 BILLION IN 1976 TO \$540 MILLION IN 1977. LED BY INCREASED EARNINGS FROM ENGINEERING PROJECTS IN THE MIDDLE EAST AND AFRICA, SERVICES WERE IN SURPLUS IN EVERY QUARTER OF 1977 AND ENDED THE YEAR AT A NET \$1.8 BILLION, UP FROM \$500 MILLION. THE DEFICIT ON TRANSFERS INCREASED SLIGHTLY TO \$2.3 BILLION AS THE OUTFLOW OF WORKER REMITTANCES SLOWED.

OUTLOOK.

9. IF THE LEFT FAILS AT THE POLLS IN MARCH, THE FRENCH CURRENT ACCOUNT DEFICIT IN 1978, PERHAPS TO \$1.7 BILLION. THE BIG GAINS OF LAST YEAR



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WILL NOT BE REPEATED.

10. DOMESTIC DEMAND WILL CONTINUE SLUGGISH, HOLDING DOWN IMPORTS. REAL GDP GROWTH SHOULD BE 3 TO 4 PERCENT, ROUGHLY THE RATE EXPECTED FOR OECD COUNTRIES AS A GROUP. AT AN ESTIMATED 8.5 PERCENT, CONSUMER PRICE INFLATION ALSO SHOULD BE NEAR THE AVERAGE FOR MAJOR COMPETITORS AND TRADING PARTNERS. THE FRENCH COUNT ON FURTHER RECOVERY IN AGRICULTURE AND MOMENTUM IN CERTAIN EXPORT LINES--FOR EXAMPLE, AUTOMOBILES--TO BRING ABOUT A LARGER INCREASE IN EXPORTS THAN IN IMPORTS. PROTECTIONIST MEASURES, NOTABLY THOSE AFFECTING STEEL AND TEXTILES, WILL MAKE THE TASK EASIER. FRENCH EXPORT VOLUME SHOULD INCREASE PERHAPS BY 5 PERCENT, ROUGHLY KEEPING PACE WITH EXPORTS BY OTHER INDUSTRIALIZED COUNTRIES. THE FAVORABLE TREND IN THE SERVICES ACCOUNT SHOULD CONTINUE.

11. A VICTORY BY THE LEFT IN MARCH COULD LEAD TO AN INCREASE IN THE CURRENT ACCOUNT DEFICIT WITHIN SIX TO EIGHT MONTHS. THE SOCIALISTS AND COMMUNISTS HAVE PROMISED HIGHER WAGES AND INCREASED GOVERNMENT SPENDING, PARTICULARLY SOCIAL WELFARE PAYMENTS. MEASURES OF THIS SORT WOULD ACCELERATE INFLATION, BOOST IMPORTS, AND REDUCE THE COMPETITIVENESS OF FRENCH EXPORTS. (CONFIDENTIAL) E1,2,3 IMPDET WNINTEL.>  
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#### WEST BANK ECONOMIC PROSPERITY CONTINUES.

1. THE WEST BANK ECONOMY HAS BEEN BOOMING IN THE PAST  
FEW YEARS--IN SHARP CONTRAST TO THE ISRAELI ECONOMY, WHICH IS  
STILL SLOWLY EMERGING FROM A PROLONGED RECESSION.\* (\*ALL WEST BANK  
DATA IN THIS ARTICLE EXCLUDE JERUSALEM,) FUELED BY  
REMITTANCES FROM EMIGRANT WORKERS, REAL WEST BANK GNP ROSE  
AT AN ANNUAL AVERAGE RATE OF ABOUT 14 PERCENT IN 1973-76,  
DESPITE A DOWNTURN IN 1975 CAUSED BY SEVERE DROUGHT,  
GROWTH LAST YEAR MAY HAVE BEEN ON THE ORDER OF  
10 PERCENT, BOOSTING PER CAPITA GNP TO ABOUT \$1,000.

2. THIS IMPRESSIVE RATE OF GROWTH HAS DONE LITTLE  
TO CHANGE THE BASIC NATURE OF THE WEST BANK ECONOMY. STILL  
DOMINATED BY AGRICULTURE AND CONSTRAINED BY A SMALL MARKET  
AND LACK OF INDUSTRIAL RESOURCES, THE ECONOMY PROVIDES  
EMPLOYMENT FOR ONLY 140,000 PERSONS. THE BALANCE OF THE WORKERS  
HOLD JOBS IN ISRAEL, JORDAN, AND OTHER ARAB COUNTRIES. ASIDE FROM  
JOB OPPORTUNITIES AND TECHNICAL ASSISTANCE IN AGRICULTURE, ISRAEL  
PROVIDES LITTLE IN THE WAY OF FINANCIAL SUPPORT TO THE WEST BANK.

WORKER REMITTANCES: THE MAIN SOURCE OF GROWTH.

3. WE ESTIMATE THAT REMITTANCES FROM WEST BANK WORKERS  
IN ARAB COUNTRIES HAVE INCREASED TENFOLD SINCE 1973  
TO A LEVEL OF ABOUT \$250 MILLION IN 1977, THANKS BOTH TO  
INCREASED MIGRATION AND SHARPLY HIGHER LEVELS OF PAY. EARNINGS  
FROM THESE WORKERS HAVE MORE THAN OFFSET THE DECLINE IN  
RECEIPTS FROM ISRAELI TOURISM SINCE 1973.

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AT LEAST 10,000 WEST BANK MIGRANT LABORERS BACK TO THE WEST BANK OR ON TO OTHER ARAB COUNTRIES.

4. THE BOOM IN REMITTANCES HAS MADE THE WEST BANK A SUBSTANTIAL NET EARNER OF FOREIGN EXCHANGE. BECAUSE OF THE LACK OF DOMESTIC BANKING FACILITIES, A LARGE PART OF THESE EARNINGS ARE HELD OUTSIDE, PRIMARILY IN AMMAN. ARAB BANKS IN THE WEST BANK HAVE BEEN CLOSED SINCE 1967, AND MOST DAY-TO-DAY FINANCIAL TRANSACTIONS ARE HANDLED BY A NETWORK OF MONEY CHANGERS. THERE ARE SEVERAL BRANCHES OF ISRAELI BANKS ON THE WEST BANK, BUT THESE DO BUSINESS MAINLY FOR ISRAELIS.

5. ONLY ROUGH ESTIMATES ARE AVAILABLE ON THE BALANCE OF PAYMENTS OF THE WEST BANK. THESE ARE SUBJECT TO WIDE ERROR BECAUSE ALMOST ALL TRANSACTIONS ARE IN CASH. MOREOVER, ISRAELI MERCHANTS GENERALLY UNDERSTATE SALES TO THE WEST BANK TO AVOID TAXES. BASED ON THE SPOTTY DATA AVAILABLE, WE ESTIMATE THAT THE WEST BANK CURRENT ACCOUNT WAS ROUGHLY IN BALANCE IN 1973, WAS ABOUT \$125 MILLION IN THE BLACK IN 1976, AND IMPROVED FURTHER IN 1977.

#### HOUSING BOOM.

6. THE INFLOW OF REMITTANCES HAS TRIGGERED A SHARP RISE IN CONSTRUCTION ACTIVITY, PRIMARILY IN PRIVATE HOUSING. WHILE CONSTRUCTION HAS SLUMPED IN ISRAEL, WEST BANK HOUSING STARTS HAVE RISEN BY 70 PERCENT SINCE 1973, AND THE NUMBER OF BUILDINGS COMPLETED HAS MORE THAN DOUBLED. ROOM ADDITIONS AND OTHER HOME IMPROVEMENTS HAVE INCREASED EVEN FASTER. AS A RESULT, THE CONTRIBUTION OF CONSTRUCTION TO GDP HAS RISEN FROM ABOUT 10 PERCENT IN 1973 TO 15 PERCENT CURRENTLY.

7. OTHER FORMS OF PRIVATE CONSUMPTION--INCLUDING LUXURIES SUCH AS REFRIGERATORS AND TELEVISION SETS--HAVE ALSO SOARED. THE BOOM IN CONSTRUCTION AND CONSUMPTION HAS NOT IN ITSELF BEEN A PRIME FACTOR IN PUSHING UP THE COST OF LIVING. ALMOST ALL CONSUMER GOODS AND BUILDING MATERIALS ARE IMPORTED FROM ISRAEL, AND THE WEST BANK INFLATION RATE--28 PERCENT IN 1976--LARGELY REFLECTS THE PASSTHROUGH OF ISRAELI INFLATION. RISING LOCAL WAGE RATES HAVE ALSO BEEN A CONTRIBUTING FACTOR.

#### GAINS IN AGRICULTURE.

8. AGRICULTURAL OUTPUT HAS EXPANDED BY 50 TO 60 PERCENT SINCE 1973. PRODUCTION OF VEGETABLES AND CITRUS FRUITS OVER THE PAST DECADE HAS EXPANDED 200%.

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COMBINATION OF INCREASED WEST BANK INVESTMENT IN AGRICULTURE AND ISRAELI TECHNICAL ASSISTANCE. AS A RESULT OF THESE GAINS, THE WEST BANK IS SELF-SUFFICIENT EXCEPT FOR FOODGRAINS.

9. DESPITE FAVORABLE PRICE AND OUTPUT TRENDS, FARMERS HAVE BEEN CAUGHT IN A PROFIT SQUEEZE IN THE PAST FEW YEARS. ISRAELI TAXES AND FUEL PRICES PUSHED UP COSTS OF FUEL, PACKAGING, FERTILIZER, AND MACHINERY TO NEARLY 20 PERCENT OF THE VALUE OF OUTPUT, DOUBLE THE LEVEL IN THE 1973/74 CROP YEAR. THE SQUEEZE, HOWEVER, HAS NOT YET MADE NEW INVESTMENTS UNPROFITABLE.

#### LIMITS ON INDUSTRY.

10. THE SMALL WEST BANK INDUSTRIAL SECTOR HAS SLIPPED FROM ABOUT 8 PERCENT OF GDP IN 1973 TO 7 PERCENT IN 1976. PRODUCTION--CONSISTING MAINLY OF HANDICRAFTS, FOOD PROCESSING, SOAP, MATCHES, AND PLASTIC PRODUCTS--HAS LANGUISHED SINCE 1973. INDUSTRIAL OUTPUT AND INVESTMENT ARE SUFFERING FROM INCREASES IN LABOR COSTS AND ISRAELI ECONOMIC POLICIES, INCLUDING HIGH PRODUCTION TAXES AND DUTIES ON RAW MATERIALS, AS WELL AS BUREAUCRATIC ROADBLOCKS DESIGNED TO IMPEDE WEST BANK COMPETITION WITH ISRAELI PRODUCTS.

11. THE MARKET FOR MOST WEST BANK INDUSTRIAL FIRMS ESSENTIALLY IS CONFINED TO THE OCCUPIED TERRITORIES. ONLY FIRMS ESTABLISHED BEFORE 1967 AND LICENSED BY THE JORDANIAN GOVERNMENT HAVE AN OUTLET TO THE ARAB WORLD. INDUSTRIAL EXPORTS, EXCEPT FOR PROCESSED AGRICULTURAL GOODS ARE VERY SMALL IN ANY CASE. THESE LIMITATIONS, TOGETHER WITH POLITICAL UNCERTAINTY, HAVE FROZEN NEW INVESTMENT. NO MAJOR INDUSTRIAL FIRMS, AND VERY FEW SMALL ONES, HAVE BEEN SET UP IN THE LAST FEW YEARS.

#### THE ROLE OF JERUSALEM.

12. PRIOR TO 1967, JERUSALEM WAS THE COMMERCIAL HUB OF THE WEST BANK AND ALSO ITS MAIN SOURCE OF TOURIST EARNINGS AND GOVERNMENTAL SERVICES. THE CITY WAS INDISPENSABLE AS A TRADING AND MARKETING OUTLET FOR THE WEST BANK.

13. ALTHOUGH JERUSALEM REMAINS A MAJOR SOURCE OF EMPLOYMENT, ITS ROLE AS A MARKET FOR WEST BANK PRODUCTS HAS BEEN TRIMMED BY ISRAELI ECONOMIC CONTROLS. MOREOVER, SINCE THE OPENING OF THE ISRAELI BORDER IN 1967, THE ROLE OF JERUSALEM AS A MARKET FOR NORTHERN WEST BANK TRADE HAS DIMINISHED.

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OUTLOOK.

14. WE EXPECT THE ECONOMY TO TAPER OFF TO A 5- TO 8-PERCENT GROWTH RATE FOR THE NEXT SEVERAL YEARS AS THE BOOM IN REMITTANCES AND CONSTRUCTION SLACKS OFF AND GNP AGAIN BECOMES MORE HEAVILY INFLUENCED BY AGRICULTURAL DEVELOPMENTS. THE BASIC CONSTRAINTS TO WEST BANK ECONOMIC PERFORMANCE WILL REMAIN. OPPORTUNITIES FOR NONAGRICULTURAL INVESTMENT ARE EXTREMELY LIMITED, AND EVEN AGRICULTURE IS BECOMING LESS ATTRACTIVE. FINALLY, AND PERHAPS MOST IMPORTANT, EMIGRATION TO OTHER ARAB COUNTRIES IS DRAINING THE AREA OF ITS SKILLED WORKERS.

15. FOR NOW, WEST BANKERS CAN LOOK FORWARD TO CONTINUED GAINS IN THEIR STANDARD OF LIVING. MOST ECONOMIC GROWTH WILL BE IN RETAIL TRADE, SERVICES, AND OTHER CONSUMER-RELATED ACTIVITIES. INVESTMENT AND DEVELOPMENT PROJECTS--PUBLIC AND PRIVATE--WILL REMAIN MINIMAL.

16. A SETTLEMENT OF THE POLITICAL STATUS OF THE WEST BANK COULD BRING A RENEWED SPURT IN ECONOMIC ACTIVITY. WEST BANKERS, NOW HOLDING LARGE FUNDS OUTSIDE THE AREA, COULD BE EXPECTED TO INVEST HEAVILY IN LOCAL INDUSTRY. IF THESE FUNDS WERE BACKED UP BY FOREIGN ASSISTANCE IN IMPROVING INFRASTRUCTURE AND BY THE RETURN OF SKILLED MANPOWER, THE WEST BANK COULD BE PUT ONTO A FAIRLY STEADY AND SUSTAINABLE GROWTH PATH. IN ANY CASE, THE MINIMUM REQUIREMENT FOR ECONOMIC PROGRESS IS A CONTINUED SECURE LINK TO PORT FACILITIES AND TO ARAB MARKETS.

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TURKEY: NEW GOVERNMENT EYES PAYMENTS CRISIS.

1. THE MONTH-OLD TURKISH GOVERNMENT OF PRIME  
MINISTER BULENT ECEVIT PROBABLY WILL ADOPT CONTROVERSIAL  
AUSTERITY MEASURES WITHIN THE NEXT FEW WEEKS IN AN  
ATTEMPT TO REMEDY THE CRITICAL BALANCE-OF-PAYMENTS SITUATION.  
FOREIGN EXCHANGE RESERVES ARE AT THEIR LOWEST LEVEL IN  
SIX YEARS, AND SHORT-TERM DEBT HAS REACHED AN ALARMING \$4  
BILLION. FORMER PRIME MINISTER DEMIREL'S NATIONAL FRONT  
COALITION FOUNDERED IN PART BECAUSE IT COULD NOT AGREE ON  
MAJOR POLICY CHANGES THAT WOULD SATISFY THE IMF AND  
PRIVATE FOREIGN BANKERS, THE SOURCE OF MUCH-NEEDED LOANS.  
ECEVIT MUST CONVINCE POLITICIANS AND PUBLIC ALIKE THAT  
STIFF AUSTERITY MEASURES ARE ESSENTIAL AND DO NOT REPRESENT  
KNUCKLING UNDER TO OUTSIDE PRESSURE.

DIAGNOSIS.

2. TURKEY HAS BEEN ENGAGED IN A FOREIGN EXCHANGE  
JUGGLING ACT FOR AT LEAST A YEAR AS OFFICIALS TRY  
DESPERATELY TO MAINTAIN ESSENTIAL IMPORTS. CENTRAL BANK  
OVERDRAFTS AND ARREARS CARRIED OVER FROM LAST YEAR AMOUNT  
TO \$1.5 BILLION TO \$2.0 BILLION. INABILITY TO PAY FOREIGN  
SUPPLIERS ALREADY HAS LED TO CUTBACKS IN INDUSTRIAL  
PRODUCTION AND SLOWDOWNS IN DEVELOPMENT PROJECTS. IRAQ  
AND LIBYA, TURKEY'S MAIN SOURCES OF OIL, HAVE STAGED  
SHORT SUPPLY CUTOFFS IN RECENT MONTHS WHEN THEIR BILLS

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WERE NOT PAID. FOREIGN EXCHANGE RESERVES HAVE FALLEN BELOW \$500 MILLION, THE VALUE OF ABOUT FIVE WEEKS' WORTH OF IMPORTS, AND EXPECTATIONS OF A SUBSTANTIAL DEVALUATION OF THE TURKISH LIRA ARE SLOWING BOTH PAYMENTS FOR EXPORTS AND REMITTANCES FROM TURKS WORKING ABROAD.

3. THE DEEPENING FOREIGN EXCHANGE CRISIS STEMS FROM SEVERAL YEARS OF RAPID ECONOMIC GROWTH AND HIGH MILITARY EXPENDITURES IN THE FACE OF SKYROCKETING OIL PRICES, A WORLD RECESSION, AND A SHUTOFF OF US MILITARY GRANT AID. DURING THIS TIME, THE GOVERNMENT HAS BEEN SUPPORTING AGRICULTURAL PRICES WELL ABOVE WORLD LEVELS, MAKING KEY EXPORTS SALEABLE ONLY ON A SUBSIDIZED BASIS. THE RESULT OF THESE AND OTHER POLICIES HAS BEEN A BALLOONING OF THE CURRENT ACCOUNT DEFICIT, FROM \$720 MILLION IN 1974 TO \$3.1 BILLION IN 1977.

4. TO FINANCE THE DEFICIT, TURKEY HAS BORROWED ABROAD AND ENCOURAGED FOREIGN BANKS--MAINLY US--TO MAINTAIN DEPOSITS OF FOREIGN CURRENCY IN TURKISH BANKS. THESE SO-CALLED CONVERTIBLE LIRA DEPOSITS PLUS CENTRAL BANK ARREARS AND OVERDRAFTS MAKE UP TURKEY'S SHORT-TERM DEBT OF \$4 BILLION. LONG-TERM DEBT, PRIMARILY OWED TO THE UNITED STATES AND INTERNATIONAL ORGANIZATIONS, AMOUNTS TO \$5 BILLION.

#### REMEDIES TO DATE.

5. THE DEMIREL GOVERNMENT BEGAN TAKING STEPS TO REDUCE THE CURRENT ACCOUNT DEFICIT FOLLOWING ITS FIRST DISCUSSIONS WITH THE IMF LAST SEPTEMBER. ANKARA DEVALUED THE LIRA BY 9 PERCENT VIS-A-VIS THE DOLLAR AND TRIMMED THE ANNUAL INCREASE IN AGRICULTURAL SUPPORT PRICES. IN ADDITION, DOMESTIC PETROLEUM PRICES WERE RAISED FOR THE FIRST TIME SINCE 1973, AND PRICES OF PRODUCTS PRODUCED BY SOME STATE ENTERPRISES WERE RAISED SUBSTANTIALY TO REDUCE THE BUDGET DEFICIT. THE COALITION GOVERNMENT BALKED AT FURTHER MEASURES--SUCH AS ANOTHER DEVALUATION AND A COMMITMENT TO FISCAL AND MONETARY RESTRAINT--NEEDED TO MEET IMF LOAN CONDITIONS AND RESTORE THE CONFIDENCE OF FOREIGN BANKERS.

6. INTERNATIONAL BANKERS, AFTER CONSIDERING LENDING MONEY TO TIDE TURKEY OVER UNTIL AN IMF SETTLEMENT COULD BE REACHED, DECIDED IN DECEMBER TO CONDITION NEW ASSISTANCE ON THE GRANTING OF

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TO \$110 MILLION POTENTIALLY AVAILABLE FROM THE IMF FOR 1978 IS SMALL CHANGE COMPARED WITH TOTAL FINANCING NEEDS, BUT TURKISH ACCEPTANCE OF IMF POLICY CONDITIONS WOULD OPEN THE DOOR TO MEDIUM-TERM PRIVATE CREDITS THAT COULD TOTAL \$1 BILLION OR MORE. TURKEY THUS IS LEFT WITH LITTLE CHOICE OTHER THAN TO ACCEPT THE IMF POLICY RECOMMENDATIONS. THE DEMIREL GOVERNMENT FELL ON 31 DECEMBER FOLLOWING THE DEFECTION OF LEGISLATORS FRUSTRATED BY THE COALITION'S CONTINUED INABILITY TO TAKE DECISIVE POLITICAL/ECONOMIC ACTION.

PROSPECTS.

7. THE NEW ECEVIT GOVERNMENT, WISHING TO AVOID TROUBLE UNTIL IT HAD WON A VOTE OF CONFIDENCE, THUS FAR HAS ONLY CATALOGUED TURKISH ECONOMIC ILLS WITHOUT PROPOSING REMEDIES. ECEVIT PROBABLY UNDERSTANDS THE NEED FOR AUSTERITY, NOTWITHSTANDING PUBLIC STATEMENTS THAT SUGGEST THE CONTRARY, AND IS LIKELY TO SEEK AN EARLY AGREEMENT WITH THE IMF. ANKARA MAY DELAY THE NEXT ROUND OF IMF TALKS AT LEAST UNTIL NEXT MONTH TO ALLOW APPROVAL OF THE 1978 BUDGET AND ENACTMENT OF OTHER ECONOMIC MEASURES. THE GOVERNMENT PROPOSALS WILL BE DIFFICULT ENOUGH TO DEFEND WITHOUT THEIR APPEARING TO BE IMPOSED FROM OUTSIDE.

8. IMF PROPOSALS DISCUSSED WITH THE DEMIREL GOVERNMENT HAD INCLUDED A FURTHER 20-PERCENT DEVALUATION, A CUT IN 1978 GOVERNMENT SPENDING IN REAL TERMS, LIMITS ON MONEY SUPPLY EXPANSION, AND A SHARP CUT IN IMPORTS- UNDER THESE GUIDELINES, REAL GNP WOULD BE SCHEDULED TO GROW BY 4.5 PERCENT IN 1978, WELL BELOW THE AVERAGE 7- TO 8-PERCENT RATE OF THE PAST FEW YEARS. THIS SLOWDOWN IN GROWTH PROVED TO BE A KEY STUMBLING BLOCK FOR MEMBERS OF THE DEMIREL GOVERNMENT, PARTICULARLY DEPUTY PRIME MINISTER ERBAKAN,

WITH ERBAKAN OUT OF THE GOVERNMENT AND PRELIMINARY FIGURES SHOWING GNP GROWTH DOWN TO 5.0 PERCENT OR LESS IN 1977, THE IMF PROPOSALS APPEAR TO BE GAINING GREATER ACCEPTANCE AMONG TURKISH OFFICIALS. THE NEW GOVERNMENT ALREADY HAS ACCEPTED THE \$4.85 BILLION IMF LIMIT ON IMPORTS, AND ECEVIT PROBABLY WILL AGREE TO THE PROPOSED DEVALUATION. HE MAY TRY TO RAISE SLIGHTLY THE GOVERNMENT BUDGET CEILING AGREED TO LAST FALL BY DEMIREL AND THE IMF, AND HE IS LIKELY TO POSTPONE RESTRICTIONS ON DOMESTIC CREDIT AS LONG AS POSSIBLE.

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9. IN THE ABSENCE OF A STANDBY AGREEMENT WITH THE IMF, EXTERNAL FINANCING CONSTRAINTS COULD RESULT IN ZERO REAL GNP GROWTH OR EVEN A DECLINE THIS YEAR. WITH IMF SUPPORT, MUCH OF TURKEY'S SHORT-TERM DEBT COULD BE RESCHEDULED, EXPORTS AND WORKER REMITTANCES SHOULD RECOVER, AND SOME REAL GROWTH SHOULD BE REALIZED. TURKEY IS IN FOR HARD TIMES IN ANY CASE. HIGH INFLATION AND UNEMPLOYMENT WILL PERSIST AND REAL INCOMES MAY FALL EVEN IF ANKARA ENACTS THE MEASURES DEMANDED BY THE IMF. TIGHT CONTROL OVER IMPORTS AND GOVERNMENT SPENDING PROBABLY WILL HAVE TO BE MAINTAINED THROUGH 1980. US RATIFICATION OF THE FOUR-YEAR DEFENSE COOPERATION AGREEMENT, WHICH CALLS FOR \$250 MILLION A YEAR IN LOANS AND GRANTS TO TURKEY IN RETURN FOR USE OF MILITARY BASES, WOULD MAKE AVAILABLE FOREIGN EXCHANGE THAT COULD BE USED TO SUPPORT DOMESTIC INVESTMENT PROJECTS. IF, HOWEVER, THE TURKS DECIDED TO BUY MORE ARMS, THE US GRANTS WOULD RESULT IN NO NET GAIN FOR ECONOMIC DEVELOPMENT OR FOR THE BALANCE OF PAYMENTS.

10. ONCE THE IMMEDIATE FOREIGN EXCHANGE SITUATION IS BROUGHT UNDER CONTROL, TURKISH LEADERS WILL HAVE TO ADDRESS STRUCTURAL ECONOMIC PROBLEMS. FOR INSTANCE, ANKARA HAS CHanneled A LARGE PORTION OF INVESTMENT INTO HIGH-COST SHOWPIECE PLANTS, SUCH AS STEEL AND ALUMINUM, OR INTO CONSUMER-ORIENTED INDUSTRIES THAT DEPEND HEAVILY ON IMPORTED MATERIALS AND ARE NOT COMPETITIVE IN EXPORT MARKETS. YET WITH 40 MILLION PEOPLE AND SUBSTANTIAL NATURAL RESOURCES, TURKEY HAS MUCH GREATER LONG-TERM POTENTIAL THAN MANY OTHER COUNTRIES AT A SIMILAR STAGE OF DEVELOPMENT. (CONFIDENTIAL WNINTEL) E1,2,3 IMPDET WNINTEL.>

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25X1A ORIG & AUTH: NFAC/ASA/D/OER [REDACTED] REL: CH, CS/NFAC  
[REDACTED] CL BY 015319.<